

## CHAPTER IV

### A DESCRIPTION OF THE CURRENT PENSION SYSTEM

#### A. The Bases of the Individual Capitalization Pension System

The underlying aim of the pension scheme laid down in DL 3,500 (1980) is to ensure that workers who have finished their working life receive a stable income, and one which bears a close relation to that received during their active life. The main bases supporting this System are:

- a. *Individual Capitalization:* The Pension System is based on individual capitalization. Each member has an individual account in which his/her social security contributions are deposited. These are capitalized and earn the yield on the investments made by the Administrators with the resources of the Funds. At the close of active life, this capital is returned to the member or his/her surviving beneficiaries in the form of some kind of pension. The amount of the pensions will depend on the amount of savings, so there is a direct relation between personal effort and the pension obtained.
- b. *Private Administration of the Funds:* The Pension System is managed by private institutions known as Pension Fund Administrators (AFPs).

These are public limited companies, whose exclusive purpose is the management of a Pension Fund and the development of other activities strictly related with the social security field, in addition to granting and administering the services and benefits stipulated in the law.

The Administrators collect social security contributions, deposit them in the personal account of each member and invest the resources in order to be able to provide the corresponding benefits later on. They also take out an insurance policy to finance any disability and survivorship pensions that may be needed by their members.

The Administrators are entitled to receive payment for their management of the Pension Funds and this is established on the basis of commissions paid at the members' expense. The commissions are fixed freely by each Administrator and are standard for all members.

- c. *Free Choice of Administrator:* The worker chooses the institution that he/she wishes to join, and may change from one Administrator to another whenever he/she thinks it advisable. He/she also has a free

choice with regard to the type of Pension Fund in which to put his/her social security savings, though in the case of older members and pensioners there are certain limitations attached to the choice of Funds with relatively higher risk, as far as their mandatory contributions are concerned<sup>21</sup>.

- d. *The Role of the State:* The State plays a vital role within the System, providing guarantees and exercising supervision, in the manner described in the next section.

## **B. The Role of the State within the System**

In fulfilling its role, the State guarantees the financing of certain benefits, issues rules to ensure that the System runs smoothly and checks that these are being kept.

### **1. Guaranteed Benefits:**

The System aims to grant its benefits fairly, so all members who fulfil certain basic requirements are entitled to receive a minimum pension, guaranteed by the State.

On the other hand, the AFPs are responsible each month for ensuring that the real yield for the past thirty-six months reaches a minimum level for each of the types of Pension Fund that they manage. This level is related to the average yield for all Pension Funds of that type during the same period. If an Administrator fails to meet the minimum yield, once all other possibilities established in the law have been exhausted, the State will pay the missing compensation and will proceed to wind up the Administrator. In the same way, where an Administrator suspends payments or is declared bankrupt, the State guarantees the following items: extra payments in case of the disability or death of a non-pensioned member, contributions<sup>22</sup>, disability pensions following a first decision, and the death benefit. In addition, in the case of suspension of

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<sup>21</sup> Members who are already pensioners may opt for any of the three Funds with lower relative risk for investing their mandatory contributions (C,D, and E); older non-pensioned members (men from 56 years and women from 51 years of age) may opt for any of the four obligatory Funds when investing those balances (B,C,D and E). Both groups may choose any of the five Funds for their voluntary contributions, agreed deposits and voluntary savings account.

<sup>22</sup> "Contribution" here means the amount representing the contributions that the member would have accumulated in his/her individual capitalization account, if he/she had paid into that account the 10% of the disability pensions paid according to the first decision. This contribution must be paid by the Administrator when a decision is issued that rejects the disability or when the member is called and does not present him/herself for the reassessment of disability within the periods laid down.

payments or bankruptcy of an Insurance Company, the State guarantees life annuities up to 100% of the minimum pension and 75% of the excess over and above that, up to a limit of 45 UF per month for each pensioner or beneficiary.

## **2. Reasons for Supervision**

In the first place, in order to ensure that workers and their families can continue to meet their needs in the face of old age, disability or death, employed workers are obliged to contribute in the AFP System. Therefore, the natural counterpart of this obligation to contribute is that the State should commit itself to safeguarding the resources accumulated in the Pension Funds.

In the second place, the state guarantees mentioned in the previous point involve the future use of government funds. It is therefore necessary to keep a check on the running of the Pension Funds so that such guarantees are granted only when members lack the means to finance the minimum pension or for reasons of force majeure, and not because of inefficiency or the malfunctioning of the System or AFP concerned.

Finally, since the Pension Funds constitute a source of financing for investment in various economic sectors in the country, it is important to keep an adequate check on these resources.

## **3. The System's Supervisory Body**

Within the System itself the State is represented by the Superintendency of Pension Fund Administrators (SAFP), this being the technical authority responsible for the oversight and control of the Pension Fund Administrators. Its functions cover the financial, actuarial, legal and administrative areas and its relationship with the Government is through the Ministry of Work and Social Security, by way of the Undersecretary of Social Security's office.

The main functions of the Superintendency are:

- i. To accept or reject the prospectus that has to be presented before a Pension Fund Administrator can be constituted, to pass its by-laws and authorize its existence.
- ii. To oversee the functioning of the Administrators in legal, administrative and financial aspects.
- iii. To ensure that Administrators comply with the minimum capital and Obligatory Reserve requirements.

- iv. To propose reforms to laws and regulations with the aim of improving the functioning of the System.
- v. To interpret current legislation and regulations and issue obligatory general rules to be applied by the Administrators.
- vi. To impose fines and order the dissolution of Administrators where necessary, in accordance with the terms of the law.
- vii. To supervise, control, oversee and fine the Unemployment Fund Administrator (AFC) with the same powers as those granted by the law with regard to AFPs.

The Superintendent of AFPs, appointed by the President of the Republic, is the Maximum Head of the Institution and is responsible for planning, organizing, directing, co-ordinating and overseeing the running of the SAFP, to ensure the efficiency of the service. He is also the judicial and extrajudicial representative of the Institution.

The Superintendency has a functionally based organization made up of six Divisions and two Units, whose main functions are described below:

- a. *Legal Department:* Its main tasks are to study, analyse and reach decisions on all legal matters within the Superintendency's jurisdiction and to take part in preparing the regulations, instructions and circulars to be issued to the individuals and Administrators under its supervision. It is also responsible for proposing such reforms to the law and regulations as may be necessary and for issuing reprimands and imposing fines on Administrators which fail to comply with the legal stipulations currently in force.
- b. *Institutional Control Division:* The main activities within its sphere of responsibility consist in overseeing the correct administration of members' individual accounts, ensuring compliance with regulations regarding publicity and information for members, intervening in processes involved in the dissolution and liquidation of Administrators and checking on the Unemployment Funds Administrator (AFC) in matters within its sphere of competence.

The organizational structure of the Institutional Control Division includes three departments: Operational and Accounts Auditing, Unemployment Insurance Auditing, Special Processes and Pensions Auditing.

- c. *Finance Division:* This division checks compliance with the regulations and policies in the financial and technical area which are applied by the AFPs when investing Pension Fund resources, and

supervises the Administrators in matters which include studying and checking the balances of AFPs and Pension Funds, compliance with investment limits, compliance with the obligatory reserve and minimum capital required by law, and checking the value of the Pension Funds' accounting units. It is also responsible for supervising the Unemployment Fund Administrator (AFC) in matters within its sphere of competence.

This Division is made up of two departments: Markets and Risk, and Financial Control.

- d. *Benefits and Insurance Division:* The function of this division is to ensure that benefits are granted to members and their beneficiaries at the correct time, as far as the Pension System and Unemployment Insurance are concerned; and to check that the Administrators actually take out the disability and survivorship insurance which they have to provide for their members through the Insurance Companies. It also has to keep a check on the granting of state guarantees.

This Division is made up of four departments: Regulations and Agreements, Statistical and Management Analysis, State Guarantee and Withdrawals and User Services.

- e. *Research Division:* This division is responsible for evaluating and planning the functioning of the System, carrying out all research which the Superintendent may request on financial, economic and actuarial matters related with the Social Security System, proposing legal changes to DL 3,500 with the relevant technical justification, and producing statistics and publications.
- f. *Internal Administration and IT Division:* The job of this division is to design and administer computational support, both for supervisory processes and for the operations carried out by the remaining divisions of the SAFP. The above includes connections with the AFPs and with institutions belonging to the capital market both locally and internationally.

As regards the Internal Administration Department, its task involves the operational management of the service in general, in areas such as budget control, accounting, purchases and the general file.

- g. *Medical Commissions Unit:* This unit is responsible for ensuring full compliance with current legislation in everything concerning the disability assessment process carried out by the Regional and Central Medical Commissions, guaranteeing that the process is fair and equitable, insisting that workers' confidentiality is respected and that they have free access to these assessments. It also settles

discrepancies of criteria where these have arisen between the Regional and Central Commissions in applying the rules for rating and assessing the degree of disability.

- h. Unemployment Insurance Unit:* This unit has to ensure that the Unemployment Insurance is functioning correctly, which means checking that the contributions of both workers and employers are up-to-date; that the unemployed receive the monetary benefits to which they are entitled in due time and manner, and that the Unemployment Fund Administrator (AFC) keeps up the coverage to which it is committed as regards attending the public, plus the other commitments laid down in the Law, the Conditions of Tender and the Unemployment Insurance Administration Contract.

The functions of the Unemployment Insurance Unit are broken down as follows: to conduct research into the behaviour of the Unemployment Insurance system, to check the quality and timeliness of benefits, to supervise the AFC's financial performance, publicize Unemployment Insurance and suggest improvements to the system.

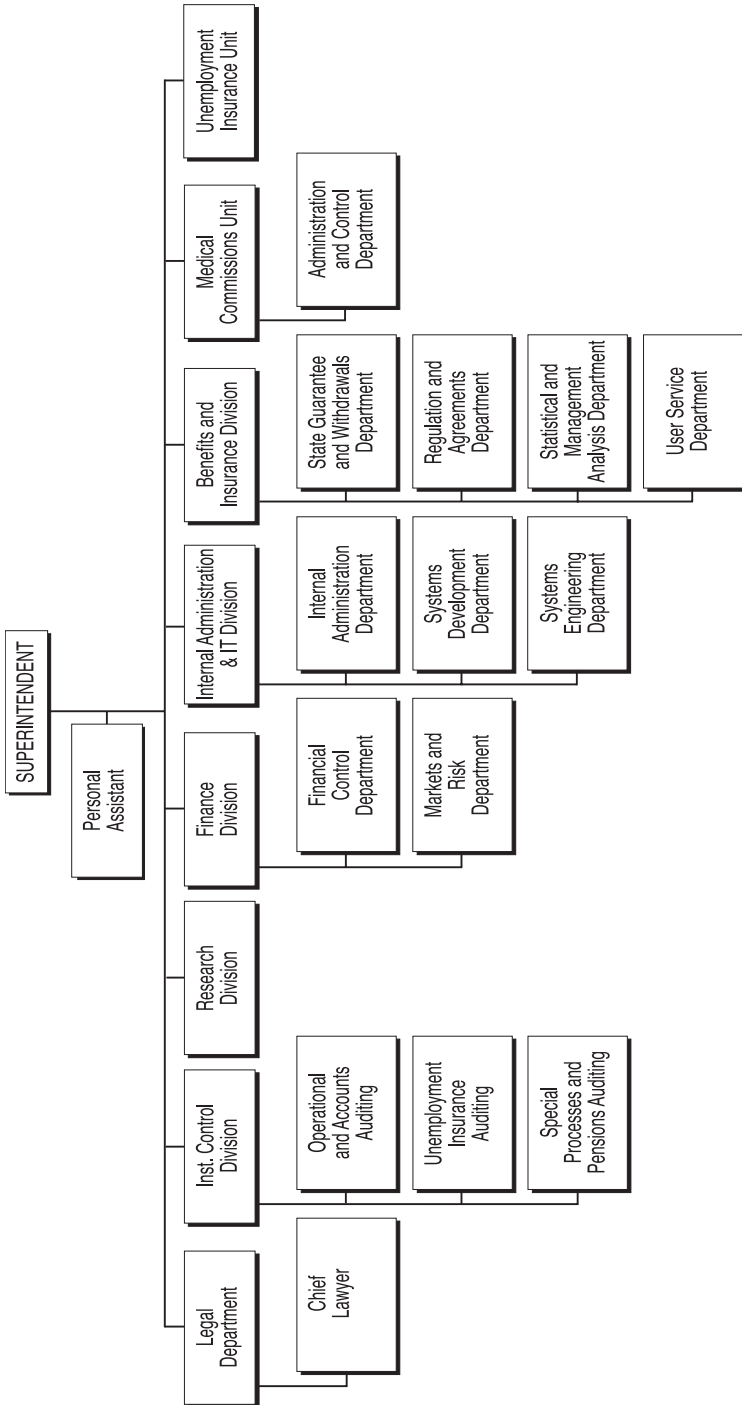
Table IV.1 shows the organizational structure of the Superintendency of AFPs.

Given the support functions assumed by the State with regard to the Pensions System, there is a body of law in existence (including laws, regulations and circulars), and compliance with this is checked constantly by the Superintendency of AFPs. In this way, protection is provided for the Pension Funds and there is a guarantee that member workers will receive the benefits laid down by the law in due time and manner.

The regulations established to govern the functioning of the System may be divided into three main areas:

- a. The investment process for the resources belonging to the Pension Funds.
- b. The functioning of the Administrators and the provision of those benefits stipulated in the law.
- c. The management of members' personal accounts, the collection of contributions, the process of exchange and transfer when a member decides to move to another Administrator, transfer between types of Funds, recovery of misplaced contributions, charging of commissions and contributions in arrears.

Table IV.1  
**ORGANIZATIONAL STRUCTURE OF THE SUPERINTENDENCY OF AFPS**



## C. Legal Coverage

Membership of the Individual Capitalization Pension System is mandatory for all employed workers beginning their working life and optional for those workers who were members of the Old System when the reform came into being. In the case of the self-employed, membership is voluntary.

The category of "member" is acquired by every worker who joins the individual capitalization system of social security, and can be lost only if the worker, after fulfilling all the legal stipulations required, decides to withdraw from the system, in which case he/she must revert to contributing under the Old Social Security System<sup>23</sup>.

The category of "contributor" on the other hand identifies the member who is actually contributing each month on the basis of the wages accrued the month before, excluding those pensioners under the new System who continue to pay their contributions.

## D. Types of Contributions

### 1. Mandatory

All members of the current Social Security System who are actually working have the obligation, in the case of employees, and the right, in the case of self-employed workers, to make regular deposits aimed at accumulating resources for their old age. The law sets these deposits at 10% of taxable monthly wages and other income, with an upper limit of 60 UF. For this purpose the Administrators have individual capitalization accounts in which they assign the regular contributions of their members. They then invest the money on their behalf in order to obtain a certain yield.

These mandatory contributions must be paid in within the first ten days of the month following that in which the remunerations accrued, or a declaration of non-payment must be made. In case of delay in payment, the AFPs may resort to collection procedures.

That part of taxable wages and income which is used to pay social security contributions is tax free.

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<sup>23</sup> This is not an option for all members. Certain requirements must be met in order to return to the old scheme.



## 2. Voluntary

As from 1st March 2002, Law N° 19,768 came into force<sup>24</sup>. This reformed the mechanism for voluntary social security saving, extending the number of institutions allowed to handle it, including banks, mutual funds, insurance companies, housing fund managers and others authorized by the Superintendency of Securities and Insurance. It also gives the resources greater liquidity and increases tax benefits, together with providing a method by which self-employed workers can gain access to the benefit.

### 2.1 Voluntary Contributions

The System has certain mechanisms that permit and encourage members to save voluntarily, and so increase the balance accumulated in the individual capitalization account and the amount of pension to be received. Alternatively, it opens up the possibility of early retirement. In the same way, these contributions can compensate for periods when no contributions were paid, due to unemployment or other causes.

The voluntary contribution alternative therefore allows the member to deposit a higher percentage of his income than the mandatory 10% in his individual capitalization account. Members may freely pay in contributions of up to 50 UF per month with tax exemption. This contribution represents a tax benefit for the member, because it is tax-exempt up to the maximum given; in other words, these payments have the same tax advantages as the basic contribution and are not taken into account when deciding entitlement to the state guarantee to minimum pension. Law N° 19,768 also makes the resources more liquid, enabling these contributions to be withdrawn by the worker at any time by paying an additional rate on the corresponding global complementary tax, or withdrawn as freely-usable surpluses<sup>25</sup>, if applicable.

### 2.2 Agreed Deposits

Workers may come to an agreement with their employers to deposit amounts into their individual capitalization account, in order to increase the capital to finance an early retirement pension or increase the amount of the pension. These sums are called agreed deposits, they are paid into the individual capitalization account and form part of the sub-total of voluntary contributions. These amounts are independent of the mandatory and voluntary contributions. The agreed sums may correspond

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<sup>24</sup> A law which introduces tax adjustments to the capital market and makes the mechanism for voluntary saving more flexible.

<sup>25</sup> A surplus with amounts which are tax exempt, dealt with in point 4 of Chapter VIII

to a fixed amount paid by the employer on a single occasion, a monthly percentage of the taxable wage or a fixed monthly amount. These sums have no limit in relation to taxable remunerations and do not constitute income for the worker, with the result that they are not liable for tax and are not considered in deciding entitlement to the state guarantee for minimum pension. Law N° 19,768 also allows these resources to be withdrawn as part of the freely-usable surplus, but this involves payment of the corresponding global complementary tax.

### ***2.3 The Voluntary Savings Account***

In August 1987 the voluntary savings account was created, also known as account two, as a complement to the individual capitalization account and in order to provide members with an additional source of savings. The voluntary savings accounts are independent of the individual capitalization account. In this account the member can make deposits, either regularly or not, and these are freely available, though there is a limit of four withdrawals a year.

Self-employed members can authorize their respective Administrators to transfer funds from their voluntary savings account to their individual capitalization account, in order to cover the corresponding social security contributions. Moreover, both employed and self-employed members can transfer all or part of the funds to the individual capitalization account when they retire, in order to increase the amount of their pension.

On the other hand, the funds accumulated in the voluntary savings account are not considered in deciding the right to the state guarantee for minimum pension, or for the additional contribution. Also, the balance in the voluntary savings account belonging to a deceased member increases his/her total estate.

The Administrator is entitled to payment established on the basis of commissions, to be paid at the expense of those members who hold savings accounts. These commissions are fixed freely by each Administrator with standard charges for all members holding such accounts. The Administrators may charge a commission on withdrawals from voluntary savings accounts. The transfer of the balance from the account to another Administrator is considered to be a withdrawal for these purposes. Commissions on withdrawals can only be established on the basis of a fixed sum per operation and in practice this commission has never been charged.

With regard to the tax position, withdrawals made from the voluntary savings account, with the exception of those used to augment the balance

in the individual capitalization account, will be liable for income tax. However, until 1993 the calculation of this tax was based on the balance held (wealth tax) and not on the earnings obtained (income tax), and in the majority of cases this tax was not charged because the balance held in the savings account had to be very large in order to be taxable. This tax position was altered by the modification introduced to DL 3,500 by Law N° 19,247<sup>26</sup>, which stated that as from 1st January 1994 the tax regime governing the voluntary savings accounts should be changed, the special system based on a single tax being replaced by the general regime contemplated in the Income Law.

The general tax scheme contained in the Income Law aims to tax the real yield received by the member in a calendar year. To do this, a factor is applied to the withdrawals from voluntary savings accounts, which weights the real profit or loss in relation to the balance in existence at the date of the operation and which makes it possible to obtain the fraction of the withdrawal corresponding to the taxable profit or the loss to be deducted from his/her annual taxable base. This value is updated at the end of the financial year on the basis of the variation in the Consumer Price Index and the member is notified by means of a certificate issued annually by the AFP before 31st January of the tax year concerned, which must contain enough information for tax purposes. The aim of this certificate is to enable the member to prepare his/her annual income tax declaration.

Members who are within the general taxation scheme may opt to change the taxation mechanism to that established in letter B of article 57 (bis) of the Income Law. Members who have a voluntary savings account and choose to take advantage of this taxation scheme for the amounts deposited in it, will be entitled to a credit which is attributable to the global complementary tax or the single tax on income from work, whichever is applicable, or, if legally appropriate, should consider a debit against the aforementioned taxes under the conditions and in the ways described in that regulation.

Despite what is stated above, the current form of taxing account two gives exemption from the global complementary tax to those members subject to the general taxation scheme who receive a quantity equal to or less than 30 UTM<sup>27</sup> in real yield and who have income consisting only of remunerations from work (wages, bonuses, etc.) or from activities such as small-scale mining, street trading, newspaper selling and ownership of handicraft workshops.

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<sup>26</sup> Published in the Official Gazette on 15th September 1993

<sup>27</sup> This corresponds to 860,850 pesos, at the UTM value for July 2002.

### 3. Compensation Savings

November 1990 saw the setting up of compensation savings accounts (CSA)<sup>28</sup>.

The aim behind the creation of these accounts was a double one: on the one hand, to provide a compensation mechanism to replace the traditional one for employed workers and on the other, to give domestic workers a compensation benefit in case the work relation comes to an end. In both cases this is unconditional compensation.

The CSAs are managed by the AFP to which the worker belongs. The account may be opened by any worker, even if he/she is not a member of the AFP System or belongs to the Old System, and later the worker may transfer the account to another Administrator whenever he/she considers it to be a good idea.

The opening of the CSA and the payment of the corresponding contributions are obligatory for persons employing domestic workers. An amount equivalent to 4.11% of the monthly taxable wage must be paid by such employers to the Administrator at their own expense for a period of 11 years, this sum to be earmarked to finance compensation which will be payable in any event leading to the termination of the work contract, whatever the cause. For other workers, whose contractual relations are governed by the Labour Code, there exists the possibility, as from the beginning of the seventh year of the contractual relation and up to the eleventh, of agreeing to substitute the corresponding legal compensations by a replacement "unconditional" compensation, which becomes effective with the termination of the work contract. Where a compensation agreement is made official, the employer is obliged to make a monthly contribution of at least 4.11% of the worker's taxable wage.

For domestic workers, the taxable wage has an upper limit of 60 UF, this being 90 UF for other workers, and the contributions are the employer's legal responsibility. Payment of contributions for compensation is governed by the same rules as the contributions for the individual capitalization account.

Neither the contributions lower than 8.33% of the taxable monthly wage nor the yield obtained on them constitute income for tax purposes.

Finally, in the event of the worker's death, these contributions provide his/her family with a certain measure of social security cover, since the

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<sup>28</sup> Law N° 19,010 published in the Official Gazette on 29th November 1990.

beneficiaries may withdraw up to 5 UTAs<sup>29</sup> from the CSA, whilst the remainder goes to augment the total estate of the deceased. This payment is made directly to the spouse, offspring or parents of the deceased, in that order of precedence.

## E. Benefits

### 1. Types of Benefit

In the Individual Capitalization System, the main benefit offered consists in the granting of pensions, of which there are three different types:

- a. *Retirement*: All members who fulfil the legal age requirement, i.e. 65 years of age for men and 60 for women, have the right, though not the obligation, to retire with a pension on age grounds.

There are no other requirements for obtaining this benefit, such as seniority in the Pension System, for example.

- b. *Early Retirement*: The Law allows early retirement, provided that the member can:
- i. Obtain a pension equal to or greater than 50% of the average taxable income for the last 10 working years,<sup>30</sup> and
  - ii. Obtain a pension equal to or greater than 110% of the minimum pension guaranteed by the State.

- c. *Disability and Survivorship*: In view of the fact that workers in general face the risk of disability or death, the Administrators are obliged to take out an insurance for their members which is called the Disability and Survivorship Insurance. This is financed by the members themselves during their active working life with a fraction of the additional contribution. Members of an Administrator who are not covered by the insurance have to finance their pension with the funds accumulated in their individual capitalization account alone.

Those entitled to this benefit are non-pensioned members who are under the legal retirement age and who have:

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<sup>29</sup> This corresponds to 1.7 million pesos as of July 2002. The amount is fixed in Annual Tax Units (UTA) in order to preserve its constant purchasing power.

<sup>30</sup> Duly adjusted for inflation

- i. lost at least two-thirds of their ability to work (the right to a total disability pension).
- ii. lost over half and under two-thirds of their ability to work (the right to a partial disability pension, a type implemented as from March 1990).

It is important to mention that those employee members who are out of work at the time when the accident occurs still retain the right to a disability and survivorship pension, as long as the disability occurs within a period of twelve months from the last contribution and the worker has contributed for at least six months in the year preceding the first month of unemployment. In the case of self-employed workers the conditions required are stricter, and they must have paid a contribution in the calendar month prior to the accident<sup>31</sup>.

Survivorship pensions are awarded to surviving beneficiaries on the death of the member (spouse, offspring or parents, depending on the case).

If there are no beneficiaries of the survivorship pension, the balance remaining in the deceased member's individual capitalization account goes to augment his/her estate.

The pension of reference for those members who are contributing in an AFP at the time of the accident is equivalent to:

- a) 70% of the base income in the case of members who die or who are entitled to a total disability pension.
- b) 50% of the base income in the case of members who are entitled to a partial disability pension.

In the case of employee members who are covered by the insurance, but are not contributing in the AFP at the time of the accident, the pension of reference is equivalent to:

- a) 50% of the base income in the case of members who die or who are entitled to a total disability pension.
- b) 35% of the base income in the case of members entitled to a partial disability pension.

The pension of reference for legal beneficiaries in the case of the member's death is calculated on the basis of a certain legally established percentage of the originator's pension of reference.

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<sup>31</sup> The State also guarantees the payment of minimum pensions in this case.

Base income corresponds to an average of the taxable wages received during the last ten years, duly updated<sup>32</sup>.

## 2. Financing of Pensions

Pensions are financed with the resources accumulated in the individual capitalization accounts belonging to each of the members. The balance accumulated represents the sum of mandatory contributions, voluntary contributions and agreed deposits made during the member's active life; plus, optionally, the funds transferred from the voluntary savings account to the individual capitalization account, if such exist; the yield earned by the Funds as a result of the Administrator's investments; the Recognition Bond, if the worker is entitled to it; the additional grant made by the AFP in case of disability and survivorship pensions, and the payments derived from the guaranteed minimum yield system. All the above, with the deduction of the cost of the commissions paid at the expense of the Fund. Pensions are also financed with state guarantee where appropriate.

The Recognition Bond, as explained earlier, is the instrument which recognizes the contributions paid under the Old System by those members who decided to change their System. This Bond becomes payable on demand when the member reaches the legal age for retiring with an old-age pension, or if the member becomes disabled or dies. However, if a member wishes to retire before the legal age, he/she can trade the Bond in the formal secondary markets, endorse it to an Insurance Company, in order to finance the premium for an immediate life annuity or ask the AFP to value the Bond, in order to calculate the pension. It should be pointed out that these transactions do not mean that the State is obliged to bring forward the payment of the Bond.

Meanwhile, the Additional Contribution refers to the payment that has to be made by the Insurance Companies into the accounts of those members who are declared disabled or deceased and who are entitled to the Disability and Survivorship Insurance. This payment is equal to the amount, expressed in UF, of the difference between the funds needed to finance the pensions referred to and the sum of the balance accumulated in the member's account, plus the Recognition Bond if there is one, as

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<sup>32</sup> For those workers whose period of membership in the System is under ten years, the base income will be calculated on the basis of the period between the month of joining the System and the month before the death occurs or the disability is declared. In this case, the sum of taxable wages and declared income must be divided by twenty-four, or the number of months that have elapsed between joining the system and the month before the event, whichever is greater. In any case, if the death or disability occurs as a result of an accident, the sum of taxable wages and declared income will be divided by the number of months elapsed from joining the system to the month before the event.

of the date on which he/she dies or on which the second disability decision is made final and irrevocable. Where the aforementioned difference is negative, the additional contribution will be zero.

### 3. Pension Options

Decree-Law 3,500 established the existence of the following pension options from which members can choose, each with its own system of financing and administration:

- a. *Programmed Withdrawal*: On retirement the worker keeps his/her Individual Capitalization Account in the Administrator to which he/she belongs, withdrawing annual amounts which are obtained by dividing the accumulated balance in the account by the capital required<sup>33</sup>. These annual amounts are divided into monthly instalments, are readjusted according to the rise in the cost of living and are recalculated every twelve months. With this kind of pension it is the AFP which manages the resources and the member who assumes the risks of longevity and reinvestment, while retaining the ownership of his/her funds.

With the implementation of the law of multifunds, members receiving pensions under this option may choose any of the three lower-risk Funds (C, D and E) for the balance corresponding to their mandatory contributions. The reason for this restriction is to avoid pensioners taking high risks in investments made with their mandatory resources, since this might have an irreversible effect on the level of their retirement pensions and on the state guarantees for minimum pensions that are involved. Nonetheless, they may choose any of the five Funds for their voluntary contributions, agreed deposits and voluntary savings account.

In addition to the above, the member may revoke his/her pension option decision at any time and change to the Life Annuity alternative.

- b. *Life Annuity*: Members may sign a contract to have their pension paid by a Life Insurance Company (chosen by themselves). This company promises to pay them a constant monthly income, in real terms, as long as they live, and to pay a survivorship pension to their beneficiaries. In this way, the member's resources are transferred to the Life Insurance Company which assumes both the financial risk

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<sup>33</sup> This is an actuarial calculation which depends on the life expectancy of the family group and the discount rate applied by the AFPs. This rate is calculated on the basis of the average yield on the Pension Fund and the interest rate implicit in life annuities.



and the risk of longevity on the part of the pensioner and his/her family group.

Once the member has chosen this pension option and signed the contract, the decision is irrevocable, because the ownership of the resources is lost.

- c. *Temporary Income with Deferred Life Annuity*: On deciding in favour of a temporary income, a contract is signed with a Life Insurance Company for the payment of a fixed monthly income, readjustable in UF, as from a date some time after the moment of retirement. Between the date on which the member requests this kind of pension and the date on which he/she begins to receive the life annuity, he/she receives a monthly pension financed with funds held specially for this purpose in his/her capitalization account at his AFP. In this way the member retains the ownership and assumes the financial risk of the part of his/her fund that remains in the AFP for a defined period in his/her life. On the other hand he/she does not assume the longevity risk, because that, like the financial risk for the second period, is covered by the Insurance Company with which he/she has signed the life annuity contract. The deferred life annuity cannot be less than 50% of the first temporary income payment nor more than 100% of that payment.

With all these pension options, if the worker obtains a pension higher than 120% of the minimum pension guaranteed by the State and higher than 70% of his average monthly taxable wage for the previous ten years, he/she may make use of the freely-usable surplus, in other words, the sum of money remaining in the individual capitalization account after the calculation of the amount needed to obtain the pension has been made and this has been deducted from the accumulated balance. This surplus may be withdrawn by the member to use for whatever purposes he/she considers appropriate.

#### **4. Guaranteed Pensions**

In the private administration system of the Pension Funds, the State provides certain guarantees related with its role in welfare.

In particular, if the member cannot cover the current minimum pension with his/her own resources, either at the moment of retirement or at some later stage, the State promises to finance the remainder, provided that:

- i. In the case of retirement pensions, the member fulfils the legal requirement of having contributed for at least 20 years in a social security system.

- ii. In the case of disability or survivorship, the member has registered a minimum of two years' contributions in the social security systems during the five years immediately preceding the moment at which he/she is declared disabled or the death occurs, or is paying contributions at the time of the event, in cases where disability or death occur as a consequence of an accident, or has completed 10 years of real contributions in any social security system.

It should be emphasized that minimum survivorship pensions correspond to percentages of the minimum retirement pension.

Among the commitments assumed by the State when the social security reform came into being, the state guarantee for minimum pensions is the largest long-term item, as far as government expenditure is concerned.

The main aim of the state guarantee for minimum pensions is to generate a source of income for those people who do not manage to save enough money to obtain a pension equivalent to the minimum, even though they have paid contributions for a significant part of their lives and who have no other sources of income.

In the case of programmed withdrawal pensions, the state guarantee is paid once the member has used up the balance in his/her individual capitalization account. In the case of life annuity pensions, the state guarantee is paid as the difference between the minimum pension and the pension received by the member. In all cases there are discounts where early retirement pensions are concerned and where the member has withdrawn freely-usable surpluses.

At present, the minimum pension is worth \$72,361.62 for members under 70 years of age, and \$79,121.84 for members over 70 years of age. Over the past 10 years the minimum pension has increased at a rate of 4.6% per year in real terms, a figure considerably higher than that observed in previous decades; between 1960 and 1990, when the real annual growth rate of the minimum pension was less than 1%.

There are a series of variables which determine whether a member will become a beneficiary of the minimum pension. Among these are the density of the member's contributions, the rate of return obtained by his/her Pension Funds, his/her income profile, the development of the value of the minimum pension over time and the fixed commission charged by the AFPs.

In March 2002, the total number of beneficiaries of the minimum pension in the Individual Capitalization System (AFPs and Insurance Companies) amounted to 33,029 in all (11,759 for retirement, 6,180 for disability and

15,090 for survivorship). This represented a cost for the government of \$21,572 million (32.9 million dollars, as of March 2002), during the twelve-month period between April 2001 and March 2002.

There are studies that seek to determine the number of members who will become beneficiaries of the state guarantee for minimum pensions and the cost that this benefit will mean for the government. The methods and assumptions used for these studies differ among themselves, as do their results. Depending on the study being analysed, the number of beneficiaries of the state guarantee for minimum pension fluctuates from less than 10% to 50% of the total number of pensioners in the System.

However, in general there is a consensus on the following aspects in the studies that have been analysed:

- Most of the beneficiaries of the state guarantee will be female members.
- The number of beneficiaries of the state guarantee and consequently the government expenditure on this item depends crucially on the rate of return obtained by the Pension Funds.

The number of beneficiaries of the minimum pension is related to the development of income distribution and the characteristics of the labour market in the national economy. To the extent that a high proportion of the workforce is receiving income equal or close to the minimum, and its participation in the labour market in employed occupations is sporadic, there will be a considerable proportion of beneficiaries for the minimum pension.

Finally, it must be mentioned that the State guarantees to contribute additional funding to complement the balance required to finance disability and survivorship pensions and, among other things, to pay life annuity pensions taken out by members with Life Insurance Companies, if one of these goes bankrupt. The coverage of this guarantee varies between 100% of the minimum pension currently in force and 75% of the excess over and above that, up to a limit of 45 UF per month for each pensioner or beneficiary.

## **5. Other Benefits**

Employed workers belonging to or joining the System of Pension Fund Administrators are also included in the Family Benefits and Unemployment Subsidy schemes, the provisions referring to work-related risks laid down in the Law on Industrial Accidents and Work-related Illnesses (Law N° 16,744, DFL N° 338 [1960]) and any other body of laws which deals with protection against this type of accident, and they will

be entitled to health benefits (Law N° 10,383 or 16,781 and Law N° 6,174) on paying a contribution of at least seven percent of their taxable wages to the respective social security institution.

In the case of the death of a member, the person who can provide proof that he/she has taken responsibility for the funeral expenses will be entitled to the death benefit, consisting of 15 UF withdrawn from the respective individual account, whether or not there is any blood relationship or matrimonial tie between that person and the deceased member.

In addition, the law considers the possibility of bringing forward the pension of those individuals who perform *heavy work*<sup>34</sup>. This is defined for these purposes as jobs which involve accelerated physical, intellectual or psychological wear and tear on most people engaged in them, producing premature ageing even where they do not cause work-related illness.

In view of this, a contribution over and above the normal 10% of wages has been fixed, to make it possible for workers involved in heavy jobs to take early retirement. This extra contribution is mandatory, bi-partite (worker – employer) and equal for workers and employers. The law stipulates that this contribution is to be equal to 2% of the taxable wage ( a total of 4% including the worker's contribution and the employer's). However, the National Ergonomic Commission may, when rating a task as heavy work, reduce the contributions laid down in the law, fixing them at 1% both for the employer and the worker (a total of 2% with both contributions).

The National Ergonomic Commission referred to above was created in order to decide which jobs should be rated as heavy work, and defines the particular tasks which, because of their nature and the conditions under which they are carried out, have the characteristics of heavy jobs.

Workers who have paid 2% contributions for heavy jobs are entitled to bring forward their retirement age at a ratio of 2 years for every 5 years of extra contributions, with an upper limit of 10 years, provided that when they retire they have a total of twenty years' contributions or countable services in any of the Social Security Systems. On the other hand this reduction will be 1 year for every 5, with a maximum of 5 years, if the contribution has been reduced to 1%.

In March 2002 there were a total of 13,595 members classified in the heavy jobs category with 4% contributions, of whom a total of 10,412

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<sup>34</sup> Law N° 19,404 (1995)

were contributing. On the other hand, on the same date there were a total of 5,047 members with 2% contributions, of whom a total of 4,038 people were contributing.

## **F. Investment of Pension Fund Resources**

This section goes through the regulations established to ensure the appropriate functioning of the System with regard to the process for investing the Pension Funds.

### **1. Eligible Instruments**

Pension Fund resources may only be invested in instruments that have been specifically authorized by law, or by the Central Bank of Chile and the Superintendency of AFPs. At this point in time, there is authorization to invest in state securities issued by the Central Bank of Chile and the General Treasury of the Republic and in Social Security Recognition Bonds: instruments issued by financial institutions, such as time deposits, promissory notes, mortgage-backed securities, bonds and shares; bonds from public and private companies; bonds that are convertible to company shares; shares of open public limited companies; shares of open public limited companies dealing in real estate, investment and mutual fund shares; commercial paper issued by companies and foreign instruments. Among these last-named are securities issued or guaranteed by foreign states, foreign central banks, foreign or international banking institutions; bank acceptances; bonds and shares of foreign companies; negotiable certificates issued by deposit banks abroad; securities representing shares indexes and short-term deposits. Pension Funds are also allowed to make operations with derived instruments for hedging financial risk and enter into share loan contracts in local and international markets.

The aim of this regulation is to give stability to the types of assets in which social security resources can be invested, the main feature that they have in common being the fact that they are financial assets for public offering. In other words, in the case of local securities, with the exception of those issued by the State, issuers are overseen by the Superintendency of Securities and Insurance or by the Superintendency of Banks and Financial Institutions, as appropriate.

### **2. Risk Rating**

From the Pension System's point of view, the risk-rating process has a double aim: on the one hand, to have a measurement of risk which allows

the agents involved to distinguish between eligible and non-eligible instruments, and on the other, to make it possible for limits to be imposed in the composition of the Pension Fund portfolio, according to the risk category of the securities.

The financial instruments issued by private institutions are subjected to different rating processes depending on their type.

For debt instruments, risk rating is carried out by private companies<sup>35</sup>. Subsequently, on the basis of at least two private ratings, the Risk-Rating Commission (RRC)<sup>36</sup> assigns a rating to the instruments for the use of the Pension Funds. The risk categories that are open to the Pension Funds are N-1 to N-3 for short-term instruments and AAA to BBB for long-term instruments. The private risk-rating companies were introduced formally into the risk-rating process of instruments for the Pension Funds by the so-called Capital Market Reform Law in the year 1994, which modified the Pension Funds Law. Its fundamental aim was to improve the evaluation of financial risk, which was formerly carried out by the RRC and was applicable only to the Pension Funds.

In the case of shares, where it is not appropriate to carry out risk-rating, it is possible to distinguish two groups: shares approved by the RRC and shares which do not need approval. The first are evaluated by the Commission on the basis of an analysis of their performance over the last three years, their hedging of financial risk and the liquidity of the company<sup>37</sup>, whilst the second may be acquired by the Pension Funds without fulfilling any prior requirements.

Investment fund and mutual fund shares are approved by the RRC on the basis of the information contained in two risk-rating reports on the shares, which are prepared by private risk-rating companies.

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<sup>35</sup> The risk-rating companies are supervised by the Superintendency of Securities and Insurance and use the following risk categories, depending on the type of instrument:

- Short-term Debt Instruments: from N-1 to N-5, the first category referring to the instruments with lowest risk and with the risk rising to N-4.
- Long-term Debt Instruments: AAA to E, with AAA corresponding to instruments with lowest risk, and rising to D.

Categories N-5, in the case of short-term and E, in the case of long-term, are reserved for those instruments whose issuers have insufficient information for the rating and where in addition there are insufficient guarantees.

<sup>36</sup> The RRC is a body with authority to classify risk and approve instruments for purposes of purchase by Pension Funds. Its president is the Superintendent of AFPs and it also includes the Superintendents of Banks and Financial Institutions, and of Securities and Insurance, plus four representatives of the AFPs.

<sup>37</sup> Shares of public limited companies dealing in real estate are approved by the RRC on the basis of a special procedure.

The procedures used by the RRC for approving foreign securities are described further on in this chapter.

### **3. Investment Limits**

The make-up of the Pension Fund investment portfolio is determined by various types of investment limits. These are fixed by the Central Bank of Chile within categories laid down in the law, on the basis of a report from the Superintendency of Pension Fund Administrators.

The law states, in general terms, that Pension Fund resources must be invested with the aim of ensuring appropriate yield and security. This definition is made operative by investment limits, among other rules. These have been modified over the course of time, incorporating quantitative and conceptual changes in the limits per instrument and issuer and introducing new limits for specific risks and groups of instruments.

- a. Per instrument: The aim of limits per instrument is to ensure an appropriate diversification of the Pension Funds' portfolios, limiting the combinations of risk and return that they can achieve.
- b. Per issuer: In this case there is a dual objective. The limit established as a percentage of the value of the Fund means that concentration of Pension Fund investment in instruments issued or guaranteed by a single institution may be kept within bounds. As regards the limit set as a percentage of the assets or net worth of the issuer, the aim is to try to avoid the Pension Fund's acquiring a significant weight in the issuer's decisions. For example, in the case of a public limited company, the idea is to prevent a Pension Fund acquiring a controlling interest.

There are also different limits per issuer, depending on the economic sector concerned. These may be defined as the financial sector (banks and leasing companies), the external sector, investment and mutual funds, the State and companies. At the same time there are different limits within each of these sectors, depending on the type of instrument concerned.

- c. Per groups of instruments: The aim of this limit is to set a maximum level for the percentage of the Pension Funds invested in certain groups of instruments.
- d. Limits for issuers related to the Administrator: the limits per issuer are subject to considerable reductions where the issue is a person related to the Administrator.

The following tables give the limits per instrument and issuer for each of the Types of Pension Fund.

Table N° IV.2  
**MAXIMUM INVESTMENT LIMITS PER INSTRUMENT FOR MULTIFUNDS**  
 (As a % of the value of the Pension Fund)

I. MAXIMUM LIMITS PER INSTRUMENT					
Securities (1)	Fund A	Fund B	Fund C	Fund D	Fund E
State (a)	40	40	50	70	80
Time deposits, bonds, other Fin. Inst. (b and c)	40	40	50	70	80
Letters of credit (d)	40	40	50	60	70
Bonds of Public and Private Companies (e and f)	30	30	40	50	60
- Bonds convertible to shares (f) (sub-limit)	No sub-limit	No sub-limit	10	5	Not eligible
Open plc shares and real estate plc shares (g and h)	60	50	30	15	Not eligible
Investment and Mutual Fund shares + Committed payments (2) (i)	40	30	20	10	Not eligible
- Mutual Funds shares (i) (sub-limit)	5	5	5	5	Not eligible
Comercial paper (j)	10	10	10	20	30
Foreing (k) (superlimit)	20				
Other authorized by the C.B.CH. (l)	1 - 5	1 - 5	1 - 5	1 - 5	1 - 5
Risk hedging operations (m)	Investment of the Fund in instruments being hedged				
Foreign currency without exchange coverage	37	22	18	13	9
Financial loan or mutuum (n)	15	10	5	5	5

II. LIMITS PER GROUPS OF INSTRUMENTS					
a) Equities					
Securities	Fund A	Fund B	Fund C	Fund D	Fund E
Equities (g, h, i, committed contributions and k and l capital)					
Maximum	80	60	40	20	Not eligible
Minimum	40	25	15	5	Not eligible
Freely available Equities (g and i)	3	3	1	1	Not eligible
Low liquidity shares (g)	10	8	5	2	Not eligible
Freely available foreign shares traded on the local stock exchange (k and l)	1	1	1	1	Not eligible



b) Fixed Income					
Securities	Fund A	Fund B	Fund C	Fund D	Fund E
BBB and N-3 (b, c, d, e, f, j and k and l: debt)	10	10	10	5	5
c) Fixed Income and Equities					
Securities	Fund A	Fund B	Fund C	Fund D	Fund E
Equities (g, h, i, committed contributions and k and l equities) + Debt BBB and N-3 + Bonds that are exchangeable for shares (f)	No limit	No limit	45	22	-
Issuers with a history of less than three years (e, f, g, j y l)	10	10	10	8	5
Restricted (g : low liquidity; g and i : freely available; k and l : Freely available and traded on local stock exchange; l: issuers with a history of less than three years; debt BBB and N-3)	20	20	20	15	-

(1) The letters in brackets refer to those used in article 45 of DL 3,500 for financial instruments.

Table N° IV.3  
**MAXIMUM INVESTMENT LIMITS PER ISSUER FOR MULTIFUNDS**

III. LIMITS PER ISSUER			
a) Financial Sector	Individual Funds	Sum of Funds	
	% Fund	% Company	% Series
Current account and time deposits and debt securities (Bank or Fin. Inst. and subsidiaries)	10% x VF x RF <sup>38</sup>	SM1 <sup>39</sup> x INW	
Current account and time deposits, debt securities and shares (Bank or Fin. Inst.)	7% x VF		
b) Foreign Sector	Individual Funds	Sum of Funds	
	% Fund	% Company	% Series
Shares	0,5% x VF		
Debt securities	5% x RF <sup>38</sup>		
Mutual and Investment Funds	1% x VF		
Freely available shares traded on the local stock exchange	0.15% x VF	7% SSh	
Freely available Mutual and Investment Fund shares traded on the local stock exchange	0.15% x VF	35% x CSh	

<sup>38</sup> The weighted average risk factor is obtained by adding the products of: the risk factor corresponding to the instrument or series issued or guaranteed by the institution and the proportion represented by the amount of the respective Fund investment in each instrument, as compared with the total value of the Fund investments in different debt securities from the same issuer. The risk factors are determined according to the rating of the instrument. Categories AAA and N-1 receive factor 1, risk category AA receives 0,9, risk category A receives 0,8, categories BBB and N-2 receive 0,6 and risk category N-3 receives factor 0,3.

<sup>39</sup> Single Multiple, its value varies between 0,5 and 1,5. It is fixed at 1,0 by the Central Bank of Chile.

c) Company Sector	Individual Funds	Sum of Funds	
	% Fund	% Company	% Series
Debt securities (individual companies)	7% x VF x RF <sup>38</sup>	SM2 <sup>40</sup> x IA	35%
Debt securities (main offices and subsidiaries)	7% x VF x RF <sup>38</sup>	SM2 <sup>40</sup> x CNBA	35%
Debt securities (companies with less than 3 years)	3% x VF x RF <sup>38</sup>		35%
Debt securities (leasing companies)	7% x VF x RF <sup>38</sup>	SM3 <sup>41</sup> x INW.	35%
Debt securities (securitization companies)	7% x VF x RF <sup>38</sup>		35%
Bonds, commercial paper and shares (individual companies)	7% x VF		
Bonds, commercial paper and shares (groups of companies)	15% x VF		
Investment Fund Shares + amount of committed payments	5% x VF x DF <sup>42</sup>	35% x (CSh+PSh)	35% new issue
Mutual Fund Shares	1% x VF	35% x CSh	
Open plc shares	5% x VF x CF <sup>43</sup> x LF <sup>44</sup>	7% x CSh	20% new issue
Banking or financial company shares	2.5% x VF x CF <sup>43</sup> x LF <sup>44</sup>	2.5% x CSh	20% new issue
Real estate shares	5% x VF x CF <sup>43</sup>	20% x CSh	20% new issue
Freely available shares	0.15% x VF	7% x CSh	20% new issue
Freely available Investment and Mutual Fund Shares	0.15% x VF	35% x CF	35% new issue

VF : Value of the Pension Fund.

CSh : Shares (Inv. or Mutual Fund) issued or in circulation.

INW : Issuer's net worth.

IA : Assets of the issuing company.

SSh : Subscribed shares.

CNBA : Consolidated net book assets.

PSh : Shares (Inv. or Mutual Fund) to be subscribed and paid.

<sup>40</sup> Single Multiple, its value varying between 0,08 and 0,12. It is fixed at 0,12 by the Central Bank of Chile.

<sup>41</sup> Single Multiple, its value varying between 0,4 and 1. It is fixed at 0,7 by the Central Bank of Chile.

<sup>42</sup> Diversification Factor. This is calculated according to the proportion of an investment fund's total assets which are invested directly or indirectly in instruments issued or guaranteed by a single issuer:

Direct and indirect investment in a single issuer	Diversification Factor
Inv. ≤ 20% of the total assets of the Fund	1
20% < Inv. ≤ 25% of the total assets of the Fund	0,8
25% < Inv. ≤ 1/3 of the total assets of the Fund	0,6
1/3 < Inv. ≤ 40% of the total assets of the Fund	0,2
Inv. ≥ 40% of the total assets of the Fund	0

<sup>43</sup> Concentration Factor. This is calculated on the basis of the maximum ownership concentration that is allowed in the company by-laws, and on whether the company is subject to Section XII of DL 3,500:

Majority Shareholder's Participation		Concentration Factor
Subject to Section XII	≤ 32%	1
	> 32% < 50%	0,8
	≥ 50% ≤ 65%	0,6
No Subject to Section XII	≤ 32%	0,6
	> 32% < 50%	0,5
	≥ 50% ≤ 65%	0,4
	> 65%	0,3

IV. LIMITS PER RELATED ISSUERS			
	Individual Funds	Sum of Funds	
	% Fund	% Company	% Series
Debt securities		3% x IA (CBNA)	5% of the issue
All securities of a company related to the AFP	1% x VF		
All the securities of all the companies related to the AFP (including direct and indirect investment)	5% x VF		
Shares, bonds and commercial paper issued or guaranteed by companies belonging to a single group	15% x VF		
Investment fund shares + amount of committed payments (when the Inv. Fund owns securities from issuers related to the AFP)		10% x (CSh+PSh)	
Investment fund shares + amount of committed payments (when the AFP is related to the administrator of the Fund)		5% x (CSh+PSh)	
Mutual Fund shares (when the Mutual Fund owns securities from issuers related to the AFP)		10% x CSh	
Mutual Fund Shares (when the AFP is related to the administrator of the Fund)		5% x CSh	
Open plc shares		2% x SSh	
Shares of banking and financial companies		0.5% x SSh	
Real estate shares		5% x SSh	

<sup>44</sup> Liquidity Factor: This is calculated on the basis of the presence and amount of transactions involving the shares on the stock exchanges (Liquidity Index). The scale fixed by the Central Bank is as follows:

Liquidity Index	Liquidity Factor
IL ≤ 20%	0,3
20% < IL ≤ 50%	0,5
50% < IL ≤ 70%	0,7
70% < IL	1

#### **4. Authorized Markets**

Transactions of financial instruments which involve Pension Fund resources can only be carried out in markets that have been expressly authorized for the purpose and that meet certain minimum requirements. These refer mainly to the simultaneous presence of buyers and sellers of instruments in order to set prices, information which is available to the public, mechanisms for negotiating instruments, necessary infrastructure and internal regulations.

This is justified by the need to ensure that trading of securities with Pension Fund resources is both fair and transparent.

All trading involving the resources of the Pension Funds must be carried out in the formal secondary market. However, debt and capital instruments being offered to the public for the first time may be acquired in primary markets, provided that these fulfil the conditions laid down in the Regulations for the Formal Primary Market. The Central Bank of Chile and the General Treasury of the Republic are also considered to be primary markets.

An exception to the rule on formal secondary markets is made in the case of investments in single instruments, issued by local financial institutions, which have not previously been traded. These transactions may be carried out directly with the issuer. Likewise, investments in mutual fund shares may be bought and sold directly from the company managing the fund. Operations or contracts concerning the loan or mutuum of financial instruments from local issuers, and financial risk hedging operations carried out with local banks which comply with the requirements established by the Risk Rating Commission are also exempted from the secondary markets rule.

The Superintendency of AFPs is empowered to oversee the transactions carried out with Pension Fund resources in the authorized markets, and those made by AFPs or individuals who, by reason of their job or position, have access to information about Pension Fund investments<sup>45</sup>.

#### **5. Securities Custody**

Securities representing at least 90% of the value of the Pension Funds must be held in custody, in the Central Bank of Chile, in foreign institutions authorized by the CBC or in private securities deposit firms.

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<sup>45</sup> This power does not affect the competence of the Superintendency of Securities and Insurance to carry out its supervisory work in the markets.

This is necessary in order to provide safe keeping for the securities representing the Pension Funds' investments. This service must be provided by institutions which have the necessary infrastructure and oversight to perform these activities.

At present, custody of financial instruments belonging to the Pension Funds in the local market is in the hands of the Central Securities Deposit, a privately owned body.

## **6. Regulation of Conflicts of Interest**

The Capital Market Law passed in 1994 laid down a series of regulations about how Administrators should behave in situations where conflicts of interests arise between them and the Pension Funds that they are managing. The most important provisions on this matter to be contained in that law are as follows:

- a. A reduction in the limits for investment in instruments issued by companies related to the Administrator.
- b. The obligation to invest resources from the Administrator's obligatory reserve in units of the Pension Fund that it manages, in order to eliminate the conflict of interests implied in managing two separate investment portfolios, one belonging to the Administrator and the other to the members.
- c. Rules that prohibit confidential information regarding Fund investment decisions from being divulged or utilized.
- d. A description of types of conduct that are prohibited for Administrators, where these may have an adverse effect on the Pension Funds or bring wrongful benefit to third parties.
- e. The inclusion of provisions designed to regulate the vote of the AFPs in elections to the boards of companies in which the Pension Funds have share participation. The rules encourage Administrators to vote for the most suitable directors, as long as they are not related to the controllers of the company. In this sense, the aim of the director elect must be to maximize the value of the company for all shareholders, while at the same time constituting a stabilizing factor on the board of directors.
- f. The regulation of the elections to the board of the AFPs, so that those elected may be concerned only with achieving the best possible management of the Fund.

- g. The regulation of transactions carried out with instruments that are eligible for Pension Funds by persons who, by reason of their job or position, are in possession of knowledge about decisions adopted by the Pension Funds regarding the purchase, maintenance or sale of securities.
- h. The implementation of internal control systems in the AFPs, which must be audited externally, in order to ensure compliance with rules on conflicts of interest.

## 7. Minimum Yield

Every month, the Pension Fund Administrators are responsible for ensuring that the annualised real yield for each of the Pension Funds under their management during the previous thirty-six months is no less than the lower of the following values:

- a. The average real annualised yield for all the Funds of the same type for the previous thirty-six months, less four percentage points for Type A and B Funds and less two percentage points for Type C, D and E Funds.
- b. The average real annualised yield for all the Funds of the same type for the previous thirty-six months, correspondingly, less the absolute value of fifty percent of that yield.

For example, if in a given month the average real annualised yield for the previous thirty-six months for all the Type C Funds is 3%, if a Pension Fund of this type has a real yield for the previous thirty-six months of less than 1%, the mechanisms established in the law for safeguarding minimum yield will come into operation. On the other hand, if the average real annualised yield for the previous thirty-six months for all the Type C Funds is 10%, if a Pension Fund of this type has a real annualised yield for that period of less than 5%, the mechanisms established in the law for safeguarding minimum yield will come into operation. The safeguarding mechanisms mentioned above are as follows:

- a. *Yield Fluctuation Reserve*: This is a reserve fund composed of the surpluses of real annualised yield of a Pension Fund which, in the previous thirty-six months, has exceeded the average real yield of all the Funds of the same type for that period by more than fifty percent or by more than four percentage points in the case of Type A and B Funds or two percentage points for Type C, D and E Funds, using the higher quantity of both.

- b. *Obligatory Reserve*: This is an asset equivalent to 1% of the value of the Pension Fund, paid with resources belonging to the Administrator, which is used to make up the minimum yield, as a subsidy for the Yield Fluctuation Reserve.
- c. *State Guarantee*: If the minimum yield is not achieved, even after applying the resources of the Yield Fluctuation Reserve and the Obligatory Reserve of the Pension Fund concerned, and the AFP does not have access to additional financial resources, the State makes up the difference and proceeds to liquidate the Administrator.

## 8. Investment Abroad

The accumulated resources of the Pension Funds grow at a high rate and this make it necessary to provide new investment alternatives for the Funds on a permanent basis, both as regards local and foreign securities. The existence of more investment alternatives makes it possible to meet the growing demand for financial assets, as well as the risk diversification needs of these institutional investors.

The maximum limit for investment abroad has been increasing since 1990, the year when investment abroad was first allowed. At this point in time, the Pension Funds may invest in foreign instruments, under the following rules:

- a. *Eligible Instruments*: The rules currently in force allow the Pension Funds to invest in credit instruments, stocks or commercial paper issued by States, foreign central banks or foreign or international banking institutions, shares and bonds issued by foreign firms, foreign mutual fund and investment fund shares, negotiable certificates representing capital or debt from foreign issuers (ADRs), securities representing shares indexes and short-term deposits. The Funds are also authorized to carry out operations for hedging financial risk, such as the risk of fluctuations between foreign currencies or interest rate risk within the same foreign currency, and enter into asset loan contracts.
- b. *Maximum Investment Limits*: The limit which is currently in force for the investment of the Pension Funds in foreign instruments amounts to 20% of the value of the Fund. It should be pointed out that the recently-passed Multifunds Law, (Law N°19,795, dated 28th February 2002), fixes the overall limit for investment abroad at 20% of the value of the Pension Fund for a period of twelve months from the date on which the law was published, then a range of between 20% and 25% of the Fund for the following twelve months and a

range of between 20% and 30% of the Fund as from March 2004, with the definitive limit within those ranges being decided by the Central Bank of Chile.

With regard to limits per issuer, the legislation envisages a limit of 5% of the value of the Pension Fund multiplied by the average weighted risk factor for debt securities, 1% of the Fund for foreign mutual funds and investment funds and 0.5% of the value of the Fund for shares.

It is worth mentioning that indirect investment in securities from foreign issuers carried out through local mutual fund or investment fund shares is included in the overall limit for foreign instruments, if these funds have more than 50% of their assets invested outside the country.

- c. *Formal Secondary Market:* All trading of foreign securities made with resources belonging to the Pension Funds must take place in the formal secondary market authorized by the Central Bank of Chile: however, in the case of foreign mutual fund shares, these may be bought and sold directly at the issuing institution. Operations or contracts involving the loan or mutuum of financial instruments are also excluded from the secondary market rule.
- d. *Investment Options:* The Administrators may carry out investment abroad by buying or selling directly from brokers or, through them, in Stock Exchanges, from clearing houses, or from other institutions allowed to operate in the formal secondary market according to the requirements laid down by the Central Bank of Chile. Otherwise it may be done through a foreign agent who must comply with the requirements stipulated in the Regulations for Investment of Pension Funds Abroad.
- e. *Risk Rating:* According to the law, all securities acquired by the Pension Funds must be approved by the Risk Rating Commission, which has set up specific approval procedures according to the security concerned. These procedures are described below:
  - *Debt Securities:* Foreign debt securities are approved by the Rating Commission on the basis of ratings made by international institutions of recognized prestige chosen by the Commission: these are Standard & Poor's, Moody's Investors Service and Fitch. The Pension Funds may only invest in debt instruments with a risk rating corresponding to investment grade, in other words, up to BBB for long-term instruments and N-3 for short-



term: this requirement is equivalent to that demanded of instruments issued inside the country.

- *Shares:* Shares issued by foreign companies are approved on the basis of the market in which they are traded. To do this, an assessment is made of the country risk, the existence of regulation, oversight and sanctioning systems for the issuer and its securities and the liquidity of the instrument in the corresponding secondary markets. The country risk is assessed according to the risk rating of the country in which the stock exchange is situated where the shares or negotiable certificates are listed, and a rating equal to or greater than Category AA is required. If a formal secondary market fulfils the requirements stipulated by the RRC, all shares and negotiable certificates traded in it in representation of the capital of foreign institutions will be approved, with the exception of those belonging to Chilean plc. However, in the case of a particular market failing to fulfil the liquidity requirements, it will be possible to analyse this requirement for that specific instrument. At present it is possible to acquire share securities in the following foreign stock exchanges: American Stock Exchange Inc. (AMEX), Borsa Italiana SpA (Italian Stock Exchange), Deutsche Börse A.G. – Frankfurter Wertpapierbörse (Frankfurt Stock Exchange), National Association of Securities Dealers Automated Quotation (NASDAQ), New York Stock Exchange (NYSE), The London Stock Exchange Ltd. (LSE), Euronext Paris S.A. (Paris Stock Exchange), Swiss Stock Exchange (SWX), Tokyo Stock Exchange (TSE).
  
- *Foreign Investment Fund and Mutual Fund Shares:* With regard to the shares of foreign investment funds, the Risk Rating Commission evaluates the country risk according to the risk rating of the country where the mutual or investment fund, the Administrator that manages it and its head office are constituted, and the rating must be at least Category A. Meanwhile the risk rating for the country whose regulations will be applicable to the mutual or investment fund, the company managing it and its head office, plus the stock exchange in which the investment fund shares may be traded, must be equal to or higher than Category AA. An assessment is also made of the existence of regulation, oversight and sanctioning systems for the management company, its head office and the mutual or investment fund, and the liquidity of the security in the corresponding secondary markets. The management company, its head office or the group to which it belongs must have a

minimum sum of 10,000 million dollars under management and at least five years' experience in managing this type of asset. Meanwhile, the mutual or investment fund must have at least 20 million dollars in assets, net of the value of contributions made by the management company or related institutions, and five contributors who are not related with them. In addition it includes restrictions on the use of derivatives, the level of debt and the provision of guarantees by mutual or investment funds.

- f. *External Custodians:* According to regulations currently in force, all foreign instruments acquired by the Pension Funds must be held in custody if they appear in a form that makes this possible. It should also be pointed out that 90% of the total Pension Fund portfolio, both local and foreign, must be held in custody in authorized institutions. The Central Bank of Chile sets the requirements to be met by the custodial institutions, having defined as authorized institutions the foreign banks or institutions constituted abroad which provide custody services, with at least five years' experience in these services and with a short or long term risk-rating of no less than A- both for the institution and its securities. Custody is also permitted in securities deposit and custody institutions abroad which are devoted exclusively to custody services, as long as they are regulated and supervised in the country in which they are constituted, have a minimum of five years experience and do not issue public offering debt securities.
- g. *Risk Hedging:* Administrators are authorized to enter into options, futures and forwards contracts using the resources of the Pension Fund that they are managing. These operations must be carried out in the formal secondary markets defined by the Central Bank of Chile and have as counterparts Clearing Houses or other institutions previously authorized by the Risk Rating Commission.

In the case of the local market, the asset involved in the options, futures or forwards contracts must be one of the foreign currencies in which the Pension Funds are allowed to invest. In any event, one of the currencies involved in the contract must correspond to the local currency or to readjustability units (UF, IVP<sup>46</sup>). Meanwhile, in the international market, the assets to which the contracts refer may be the foreign currencies in which the instruments obtained as a result of investment with Pension Fund resources are expressed, or foreign interest rates for instruments which may be acquired by these Funds.

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<sup>46</sup> (IVP) Average Value Index

The safeguards for these operations are concerned with: limits on investment and rules referring to excess investment, valuation of operations, accounts and information which the Administrators have to provide for the Superintendency, and requirements demanded of the counterparts.

## **9. Valuation of Instruments**

According to the terms of DL 3,500, the value of the accounting unit of each Pension Fund is fixed daily on the basis of the economic or market value of the investments. The valuation methods for the different instruments are therefore based on this principle, in order to avoid unintentional transfers of wealth between members of the System as a result of resources flowing in and out of the individual accounts.

For these purposes, the instruments that are eligible for the Funds may be divided into four groups: financial intermediation, fixed income series, capital and derivatives.

### ***9.1 Financial Intermediation Instruments***

Financial intermediation instruments, with amortization and interest payment at term, are valued daily according to their economic value, using for the purpose the Internal Rate of Return (IRR) obtained from the transactions carried out in the formal secondary markets. In order to decide on the relevant rate, these instruments are grouped by category, with all local financial intermediation instruments of the same type, risk rating, term conditions and systems of readjustment or currency belonging to a single category.

In the case of financial intermediation instruments with interest paid prior to term, these are valued in a manner similar to that used for instruments in series, which is described below.

Among the instruments valued by applying these methods are the deductible promissory notes of the Central Bank of Chile, the promissory notes and time deposits of financial institutions and the commercial paper issued by companies.

### ***9.2 Fixed Income Series Instruments***

Fixed income series instruments are valued daily at the current value of future cash flows, discounted at the relevant market rate. The relevant rate is the average weighted IRR of the valid transactions in instruments belonging to a single category. All local fixed income instruments of the same type and issuer belong to the same category, as long as they have

similar general conditions regarding term, book rate at issue, system of re-adjustment or currency, guarantees, etc.

In this way, the fixed income instruments are valued on the first working day of each month at least, - provided that there are valid transactions in the formal secondary markets that modify the IRR, implying coupon cutting or the application of an adjusted IRR, - using the average weighted IRR of the operations, calculating the price of the instrument for that day, the price for the last working day in the month and the daily amount accrued.

If on a particular day there is no trading in fixed income instruments of a single category and no calculation is made of the adjusted IRR as mentioned in the previous paragraph, they are valued using the IRR applied the day before, with the corresponding accrual factor.

At least twice a month a check is made of the IRR used to value the categories of fixed income instruments that have presented no valid trading between adjustment periods. The adjusted IRR is calculated using the average weighted IRR for adjacent categories if the instruments include a pre-payment option. On the other hand, the adjusted IRR will correspond to that fixed when valuing the instruments, with portfolios of issue certificates readjustable in UF (cero bonds) or issue certificates readjustable in dollars (ZERO bonds) as appropriate, issued by the Central Bank of Chile, which repeat their flows, plus a spread, if they do not have pre-payment options.

The instruments to which this valuation methodology is applied are basically readjustable promissory notes from the General Treasury of the Republic, readjustable promissory notes from the Central Bank of Chile, letters of credit issued by financial institutions, company bonds and financial institution bonds.

### **9.3 *Capital Instruments***

Among capital instruments there are company shares and investment and mutual fund shares. Company shares are valued daily at the average weighted price of the last day of valid transactions, weighted according to the percentage representing the number of units traded in each of the operations compared with the total number of shares traded in the day. Valid transactions on a given day are taken to mean those where the amount involved in the operation on that day in each formal secondary market is greater than, or equal to, 150 UF.

As regards investment fund shares, there are two methods of valuation in use:

- i. When their annual presence on the stock exchange is less than 20%, the shares are valued daily on the basis of the average weighted value of the transactions carried out up to the date of valuation. Thereafter this price is periodically adjusted to the book values of the share, fixed in accordance with the Annual or Quarterly Financial Statements of the investment fund. The first adjustment to book value is carried out twelve months from the beginning of the investment fund's operations, and may be carried out earlier where these funds make an economic or market valuation of their assets, which is included in the Financial Statements.
- ii. When their annual presence on the stock exchange is equal to or greater than 20% and they have at least three months' trading behind them, they are valued in a way similar to that used for company (plc) shares.

Meanwhile, mutual fund shares are valued according to the latest available price (redemption value) obtained from data bases established by the Superintendency of AFPs.

#### ***9.4 Derivatives***

The valuation of financial risk hedging operations carried out by the Pension Funds is done differently, depending on whether options, futures or forwards contracts are involved.

Options are valued daily according to the simple price of the last three days' transactions in the formal secondary markets (in the case of currency options in the local market, a weighted average is used). These days must be included in the 15-day period immediately preceding the date of valuation. If there are no transactions within that period, the price taken will be the price as of the last day on which transactions were registered. Only those transactions for an amount of 50 UF or more will be taken into account.

The valuation of options is carried out independently for each series. In this regard it is to be understood that options of the same type, with the same underlying asset, the same exercise price and the same date of expiry are part of the same series, "type" in this case meaning call or put options.

When the options are not traded in the formal secondary markets in the 15-day period immediately prior to the date of valuation, a fortnightly adjustment is made, the value being taken as the maximum amount between the intrinsic value of the option and its value as an insurance premium. The intrinsic value corresponds to the maximum between zero

and the difference between the exercise price of the option and the price of the underlying asset at the moment when the valuation is made. The value as an insurance policy is understood to be the value assigned to the option the last time it was traded, depreciated in a linear manner according to the date of trading, the date of valuation and the expiry of the contract, according to the following formula:

$$VI_j = \left( TP - \left( \frac{TP \times DT}{DE} \right) \right)$$

Where:

$VI_j$  : The value of option  $j$  as an insurance premium.

$TP$  : Corresponds to the valuation price when the option was last traded.

$DT$  : Corresponds to the number of days elapsed between the last time the option was traded and valuation day  $t$ .

$DE$  : Corresponds to the number of days between the date when the option was last traded and the expiry date of the option.

In the case of futures contracts the valuation formula should not be applied where daily profits or losses arising from these contracts are received or entered through the daily margins of variation set by the Clearing House which acts as the Pension Funds' counterpart in these operations. If these contracts do not involve margin compensation, the valuation is carried out in a way similar to that used in the case of forwards contracts.

In the case of forwards, the market value corresponds to the updated difference between the forward price agreed in the contract and the market forward price in force on the valuation day. If there is no market forward price for the month during which the contract expires, the market price for the nearest expiry date to that of the forward contract will be used. Where there is no market forward price for any maturity, the spot or cash price of the asset underlying the contract is used.

Finally, it is worth pointing out that, as far as foreign instruments are concerned, these are valued using the bases described above for local instruments, with the variations proper to the international markets in which they are traded.

## G. Commissions Structure

The Law of Pension Funds lays down the following principles for the commissions used by the AFPs to finance their operations:

- a. The Administrators fix the level of commissions *freely*, within the structure established in that same law.

In other words, given the fact that the commissions are simply the price of a service, it is assumed that members' freedom to choose their AFP, plus the competition between these institutions, will produce an appropriate level of commissions from the point of view of the overall assignment of resources.

- b. Commissions must be *standard* for all members of the same type and for all the Funds managed by a single AFP. The term "member of a given type" refers to employed members, the self-employed and members with no right to disability and survivorship insurance.

The following table shows the basis on which commissions are applied and the way in which they are calculated.

Table N° IV.4  
COMMISSIONS STRUCTURE

	Individual Capitalization Accounts (ICA) Mandatory Contributions			Voluntary Savings Account (VSA)	Compensation Savings Account (CSA)	ICA Voluntary Contributions and Agreed Deposit
	Active Members		Pensioners			
Item	Deposit of contributions	Transfer of balance from another AFP	Withdrawals by temporary income or programmed withdrawal	Withdrawals or transfer to another AFP	Deposits	Balance Management
Structure	Fixed sum, % of taxable wages, or a combination of both	Fixed sum or % of balance	Fixed sum, % of withdrawal or a combination of both	Fixed sum	Percentage of deposit	Percentage of balance

It should be pointed out that the Administrators use only some of the commissions that they could charge. At present, no AFP is charging commission for managing the Voluntary Savings Account, the Compensation Savings Account, or for transferring a balance from another Administrator.

As regards commissions on contributions deposits, Administrators charge both types. Currently only one AFP does not charge the fixed commission. The commission expressed as a percentage of contributors' wages for deposits of contributions is called the additional contribution. Unlike other commissions, only part of this commission constitutes net income for the AFP. A certain fraction of it is transferred to the Life Insurance Companies as a premium for the disability and survivorship insurance used to provide coverage for contributors.

In addition, members who transfer any of their balances more than twice in one calendar year between the Funds of the same Administrator, whether mandatory contributions, voluntary contributions and agreed deposits or their voluntary savings account, they must pay an exit commission. This commission cannot be deducted from the Pension Fund, in other words the member has to pay it directly.

Concerning commissions for programmed withdrawal, six of the seven Administrators charge only the percentage commission on the withdrawal and the remaining Administrator charges only the fixed commission under this item.

Finally, with regard to commissions on the balance, which AFPs are allowed to charge for managing the agreed deposits and voluntary contributions, all the AFPs in the System are in fact charging them. They may also charge a commission for collecting and transferring agreed deposits and voluntary social security savings to the authorized institutions chosen by the member. This can only be a fixed amount per operation, which will be deducted from the deposit and must be the same for any of the institutions chosen by the member.

## **H. Information for Members**

The Pension System derived from individual capitalization offers workers a whole set of chances to choose. In the first place, on entering the System, workers have to choose the Administrator to join and the Fund to which they want to be assigned. Later on they can, if they wish, transfer by choosing a new Fund, a new Administrator or both. In the second



place, the age for retirement from working life is not fixed, and in fact it is possible to bring the retiring age forward or postpone it. Finally, once the requirements for retirement are met, members can decide between three alternative pension options.

However, if members are to use these alternatives for their benefit, they must have access to the necessary information, so that each time an opportunity for choice arises they can opt for the alternative that is closest to their preferences. For this reason, both the Pension Funds Law and the regulations issued by the SAFP are orientated towards producing objective, timely information for members.

In the first place, the advertising used by the Administrators is governed by specific regulations contained in Circulars issued by the Superintendency of AFPs. This is based on the fact that the Pension System is complicated and that Administrators could misinform their members through advertising. It aims especially to ensure that the advertising is truthful and does not give rise to errors or confusion about the Administrator's institutional or patrimonial position or about the goals and bases of the Social Security System. If an Administrator fails to comply with the conditions and requirements explained above, in other words, if it is considered that the advertising may confuse the members, the Superintendency will request the Administrator to modify or suspend it and will apply sanctions in justified cases. The way in which oversight is exercised consists in analysing the advertising material used by each Administrator in both social and journalistic means of communication: magazines, radio, television, pamphlets and other forms of publicity.

In the second place, the Administrators are bound to provide all members with the following information:

- a. *Four-monthly Summarized Statement:* Three times a year, in the months of February, June and October, all members whose capitalization account has shown some movement during the previous four-month period receive a summary, at their home address, of the movements in their account during the last four months: deposits, charges and balance, both in pesos and in units. The format of the statement was designed by the SAFP and all AFPs are obliged to use it. This makes it easier to understand the contents even when the member changes from one Administrator to another<sup>47</sup>.

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<sup>47</sup> All members of the System receive at least one statement in the year, even when their account has shown no movement at all.

- b. *Information about the Yield of the Individual Capitalization Account:* In order to make it possible for members to compare the performance of the various AFPs over time, the Superintendency of AFPs brings out an indicator of the yield of the individual capitalization account, every four months. This indicator shows the yield of the account for five pre-determined levels of income: minimum income, 10, 15, 30 and 60 UF, and must be sent by the AFPs to members together with the summarized four-monthly statement. The members receive comparative tables containing the yield of the individual capitalization account obtained by each AFP and for the Fund to which it is attached for the following periods: historic, past 144, 72, 36 and 12 months.

One of the main features of this indicator is that it is calculated after deducting all the commissions that members have to pay to the AFP, even though the variable commission does not directly affect the balance in the account. In this way the cost of providing the service offered by the AFPs is reflected at the same time as the yield.

Thus the yield of the account measures the real profit or loss which a hypothetical member would have obtained in his/her ICA if he/she had stayed in an AFP for any of the periods referred to above, deducting the social security cost.

- c. *Information about the yield of the unit:* The yield of the unit is published together with the yield of the ICA. This yield shows exclusively the yield obtained by the investments made by the AFPs with the Pension Funds and does not depend, therefore, on the accumulated balance or the commissions charged. For this reason it is the same for all the members of an AFP.
- d. *Information about the commissions structure and social security cost:* In addition to the above, the AFPs have to send their members, together with the statement, a table with the commissions charged by each of the Administrators and a calculation of the monthly social security cost for contributors, whether employed, self-employed, without the right to disability and survivorship insurance or pensioners, as appropriate, and the annual difference in cost between one Administrator and another. This calculation is made for the same income levels as are used for calculating the yield of the account.

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<sup>48</sup> Under the multifund scheme, a system has been set up for those members who do not state a choice regarding the Funds in which they wish to stay, whereby they are assigned gradually to Pension Funds that are appropriate to their age-group, transferring 20% of their balances per year over a period of 4 years.

- e. *Information about being assigned to a Fund:* In order to provide information to the member about transfers of resources between Funds, when he/she has not made a choice, the Administrator is obliged to send information referring to the transfer of his/her resources to the Fund which corresponds to his/her age-group<sup>48</sup>. This must be sent together with the four-monthly statements, twelve months before the first transfer of funds and up to twelve months after the last transfer.
- f. *Social Security Book:* Each AFP must provide members with a social security book, in which the worker may ask for the balance in his/her ICA, in units and pesos, whenever he/she thinks fit.
- g. *Summarized Four-monthly Statements for the Voluntary Savings Account and the Compensation Savings Account:* All members who have opened these types of account receive an independent statement for each of them every four months, with the same characteristics as the ICA statement.
- h. *AFP Information Board:* Every AFP must have an information board on display in all offices that are open to the public. The organization, size and distribution of these are regulated by the SAFF. Each board must show:
- Commissions that members will be charged.
  - Details of each of the Pension Funds: real annual yield of the unit, extracted from the latest calculation made by the SAFF, real annual yield of the ICA, extracted from the latest calculation made by the SAFF, the value of the Pension Fund, the composition of the Pension Fund portfolio and the value of the unit as on the penultimate working day.
  - Details of the Administrator: subscribed capital, paid capital, obligatory reserve, net worth, name of the managing director and other directors, etc.
- i. *Information Leaflets:* The AFPs must make information leaflets available to the public on different aspects of the Pension System. These must be worded in simple language, because their main aim is to answer members' queries. The main subjects are: Pension Funds, Benefits of the System, Pension Options, Recognition Bond, Complaints, Individual Account, Voluntary Savings Account, Commissions, Transfers, Statements, Voluntary Social Security Saving, Multifunds, etc.

The Statistical Bulletin published by the SAFP is in addition to the above and consists of five sections. The first contains information for members such as commissions, social security cost, the composition of the additional contribution, yield for the account and the unit and information about regional medical boards. The second part is dedicated to the System's demographic and economic statistics, such as members and contributors by sex, AFP, region of residence, balance in the ICA, taxable income, etc. The third part is given over to financial information about the Pension Funds, such as their assets and liabilities, collection of contributions, and the diversification of the portfolio by instruments. The fourth part consists of information about the Administrators, specifically giving a list of directors and shareholders and the balance and operating statements of the AFPs. Finally, the fifth section gives information about interesting economic indicators such as taxable income by region and economic activity, amount of the minimum pension and minimum income.

In addition to the above, the Superintendency has an office to attend the public and a web site, giving members better access to information and orientation with regard to the Pension System.

## **I. Delinquency**

DL 3,500 stipulates that the employer must retain the social security contributions for employed workers and make the deposit in the AFP to which the worker belongs. Social security contributions must be paid by the employer within the first ten days of the month following that in which the wages accrued. If the employer does not pay the contributions, he/she must declare them within that same period of time. The law states that where the employer makes the retention but does not make the corresponding payment, the debt must be paid with readjustments and penalty interest. When this occurs, the Administrators are obliged to take the administrative and legal actions needed to ensure that the contributions owed are indeed collected.

Contributions that are not paid at the correct time are readjusted by the CPI. At the same time, for each day's delay in payment, the readjusted debt accrues penalty interest equivalent to the current interest rate for readjustable operations in local currency, increased by twenty percent. If, in a given month, the readjustment and penalty interest, increased as stated, is less than the interest for non-readjustable operations as fixed by the Superintendency of Banks and Financial Institutions, or the nominal average yield for the last twelve months of all the Pension

Funds, all increased by twenty percent, the higher of these two rates is applied, in which case the readjustment is not applied. Readjustments and interest are paid, together with the contributions, into the member's individual capitalization account. However, the interest surcharge, equivalent to 20% of the interest which would have been payable if applying simple interest on the readjusted debt, is for the benefit of the AFP.

The stage of prejudicial collection runs from the date on which the contributions are declared, with a maximum period of 180 days. During this period the AFPs take all the steps necessary to aid collection: communicating with the employer in writing, by telephone and by personal contact. Once this period is over, if payment has not been obtained, the judicial collection stage begins. This is characterized by the issuing of a judicial collection execution paper (resolution).

In the AFP System, if the employer does not declare the contributions, or if the declaration is incomplete or false, he/she is liable to a fine of half an UF for each worker, payable to the Treasury. It is the responsibility of the Labour Department to oversee employers' compliance with social security obligations and also to apply sanctions.

Once the AFPs have carried out the monthly process of updating the individual accounts, they must detect those employers who have not paid or declared their workers' social security contributions and notify the Labour Department directly, in order to obtain through that Body the information needed to clarify possible unpaid contributions on the part of the employer.

The concept of delinquency is defined in the law as unpaid contributions. The amount of unpaid contributions is reflected in the financial statements and accounting of the Pension Fund in memorandum accounts. This is a way of representing the Administrator's responsibility to actually charge the employers for these contributions, which, once paid, will go to form part of the Pension Fund's net worth and consequently the individual fund of the members affected by the non-payment. The balance of unpaid contributions records the amount for which no payment has been received from the employer at the close of a given financial year.

The breakdown of these memorandum accounts is as follows:

- a. *Declared Unpaid Contributions*: This item includes those contributions to the Pension Fund that have not been paid in within the specified

period and for which the employer made a Declaration without Payment. In other words, in this case the employer, by means of a form which he/she has signed, recognizes his/her debt with regard to his/her employees.

- b. *Unpaid Contributions resulting from non-tallying Payrolls:* These correspond to contributions to the Pension Fund which are unpaid because of errors committed by employers, in the sense of having paid an AFP less in contributions than the total obtained in the details of the payrolls.
- c. *Non-declared Unpaid Contributions:* These are those contributions presumed to be in default, the balance of which is estimated by the Administrators. Part of this delinquency is the result of non-payment by employers who do not declare the contributions owing to their employees. In this case it is only possible to achieve payment by taking legal action before the courts or by inspections carried out by the Labour Department. This item also includes all omissions and errors committed by the employer with regard to imbalances due to unemployment, termination of contract or voluntary withdrawal of workers which the employer has failed to report.

The statute of limitation which extinguishes actions for collecting social security contributions, fines, readjustments and interest runs for 5 years, counting from the date on which the contractual relationship was terminated.

Table N° IV.5  
**CHRONOGRAM OF THE COLLECTION PROCESS**

